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No. 90-1929

In the Supreme Court of the United States

October Term, 1990

PENNSYLVANIA POWER COMPANY,
Petitioner

vs.

PENNSYLVANIA UTILITY COMMISSION and
PENNSYLVANIA OFFICE OF CONSUMER ADVOCATE,
Respondents

On Petition for a Writ of Certiorari to the Supreme Court of Pennsylvania

BRIEF FOR RESPONDENT PENNSYLVANIA PUBLIC UTILITY COMMISSION IN OPPOSITION

Commonwealth of Pennsylvania
Pennsylvania Public Utility
Commission
P.O. Box 3265
Harrisburg, PA 17105-3265
(717) 787-5000

JOHN F. POVILAITIS
Chief Counsel
BOHDAN R. PANKIW
First Deputy Chief Counsel
KEVIN J. MOODY*
Assistant Counsel
Attorneys for Respondent
Pennsylvania Public Utility
Commission

*Counsel of Record

July 22, 1991

Murrelle Printing Co., Box 100, Sayre, Pa. 18840—(717) 888-2244

QUESTION PRESENTED

Do *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988), and *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), prevent a state public utility commission from determining whether a state electric utility's voluntary short-term wholesale purchase of electric power from a non-affiliated supplier is needed to provide safe and reliable electric service to its retail customers, where the Federal Energy Regulatory Commission did not order or otherwise review the purchase?

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STATEMENT OF THE CASE

The opinion of the Commonwealth Court of Pennsylvania, reported at 561 A.2d 43 and reproduced at Appendix B, pages 2a-23a, of the petition for certiorari ("Petition"), fairly and adequately sets forth the facts of this case. The Pennsylvania Public Utility Commission ("PUC") will address the inaccuracies in the Pennsylvania Power Company's ("Penn Power") Statement of the Case in the course of its argument demonstrating why this Court should deny plenary review in this matter.

SUMMARY OF ARGUMENT

This case does not present a federal question arising under the Federal Power Act or this Court's decisions in *Nantahala* and *Mississippi Power*. On the contrary, the facts below demonstrate that this case represents no more than a typical voluntary wholesale purchase of electric power by a retail electric utility company from a non-affiliated supplier. The reasonableness of this wholesale purchase decision is not and has never been subject to FERC jurisdiction. For this reason, Penn Power's position would completely insulate a retail utility's wholesale power purchase decisions from state review.

Penn Power agreed to purchase 12 megawatts ("MW") of electric power for 18 months from a non-affiliated utility. The PUC made a state law determination that Penn Power did not need this small amount of capacity to provide electric service to its retail customers during this short period of time. The PUC's determination falls wholly outside FERC's jurisdiction to determine the justness and reasonableness of wholesale electric power rates and allocation agreements affecting such rates.

The lower courts' orders affirming the PUC's state law determination neither "trap" costs that FERC has ordered a utility to incur nor present any threat to FERC's exclusive jurisdiction to order allocations of power among affiliates operating within an integrated, interstate power pool. Accordingly, there is no need for this Court to review this matter.

ARGUMENT

I. THE FACTS OF THIS CASE DO NOT PRESENT THE ISSUE RAISED BY THE PETITIONER

The PUC would not have denied Penn Power full recovery of the Perry I buyback costs if the question presented by Penn Power was actually involved in this litigation. This case involves a short-term (18-month) wholesale purchase of a small quantity (12 MW) of electric power that was not needed for Penn Power to provide safe and reliable electric service to its retail customers. This case does not involve a transaction between affiliates or a power allocation agreement underlying a FERC determination of just and reasonable wholesale rates. The issue presented by this case falls wholly outside the preemptive scope of the Federal Power Act, 16 U.S.C. §§791a-828c, and this Court's decisions in *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988) ("*Mississippi Power*") and *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) ("*Nantahala*").

A. The Parties To The Perry I Buyback Are Not Affiliated, And CAPCO Is Not An Integrated Power Pool.

Nantahala involved FERC's adjustment of a power allocation between two affiliates, Nantahala Power & Light Company ("NP&L") and Tapoco, Inc. Wholesale customers of NP&L complained that the allocation agreement between the affiliates unreasonably increased NP&L's wholesale power costs; that complaint proceeding was consolidated with NP&L's previously-filed wholesale rate increase request. *See Nantahala Power & Light Co.*, 19 F.E.R.C. ¶ 61,152, pp. 61,273-74. The affiliates' agreement allocated the annual amount of low-cost entitlement power received from the Tennessee Valley Authority ("TVA"), which operated eight of

NP&L's eleven hydroelectric power plants and poured the power therefrom into the TVA power grid. FERC determined that the allocation agreement unfairly allocated an insufficient quantity of the low-cost entitlement power to NP&L, thus requiring NP&L to obtain too much high-cost "purchased power" from the TVA power grid in order to meet the demands of its customers. *Id.* at pp. 61,279-80.

The utilities in *Mississippi Power* were also affiliated, and operated within a fully integrated, interstate power pool system:

> MP & L [Mississippi Power & Light Company] is one of four operating companies whose voting stock is wholly owned by Middle South Utilities (MSU), a public utility holding company. The four companies are engaged both in the wholesale sale of electricity to each other and to companies outside the MSU system and in the retail sale of electricity in separate service areas in Louisiana, Arkansas, Missouri, and Mississippi. Through MSU the four companies operate as an integrated power pool, with all energy in the entire system being distributed by a single dispatch center located in Pine Bluff, Arkansas.

Mississippi Power at 357 (footnote omitted).

In contrast, Penn Power and the Cleveland Electric Illuminating Company ("Cleveland Electric"), the parties to the Perry I buyback, are not affiliated. *See* Petition at (ii) ("List of Interested Parties"). Furthermore, the organization to which these two utilities belong, CAPCO, was not an "integrated"[1]

[1]According to FERC, in an "integrated" or "tight" power pool, "*single system operating economy* is assured by *central dispatch*." Federal Energy Regulatory Commission, *Power Pooling in the United States*, Washington,

power pool in 1980 when the Perry I buyback agreement was executed[2], or in 1988 when Penn Power sought to recover the costs of this wholesale power purchase through its retail rates. *See Pennsylvania Public Utility Commission v. Duquesne Light Co.*, 66 Pa. P.U.C. 518, 712 n.2 (1988). ("At the present time, CAPCO does not operate as a power pool or a regional reliability council.") Penn Power's description of CAPCO as "an integrated power pool" (Petition at 2) is simply not accurate.[3]

Part II of this Brief demonstrates that agreements allocating power among affiliates provide the basis for FERC's special exercise of jurisdiction to order allocations of power for the purpose of determining just and reasonable wholesale rates.

The total absence of these factors in this case clearly demonstrates that this matter does not involve the issue of federal preemption presented to this Court by Penn Power.

DC, U.S. Government Printing Office, 1981, p.9 n.2. (emphasis added). According to FERC, there were only nine "tight" power pools in the United States in 1981. CAPCO is not among them. *Id.* at p. 8, App. at 1b.

[2]CAPCO does not utilize central dispatch; indeed, mandatory planning on a single system basis has been eliminated by the CAPCO companies. Each member company is responsible for the planning of the bulk power facilities for its system. Balancing of available reserves is done on a negotiated basis. *Power Pooling in the United States* at p. 98.

[3]Although CAPCO is not an integrated power pool, Penn Power and its parent company, Ohio Edison Company, operate "a fully integrated, jointly planned and dispatched system." Petition, App. at 31a.

B. The Short-Term Perry I Buyback Is Not An Allocation Of Power, FERC-Mandated Or Otherwise.

The Perry I buyback was a simple, short-term (18-month) wholesale purchase of electric power and not an "allocation" of power among affiliates required to be filed with FERC so that FERC could determine just and reasonable wholesale rates as in *Nantahala* and *Mississippi Power.* Penn Power acknowledges that *the buyback agreement* (the basis of the alleged "allocation") *was never even filed with FERC.* Petition at 13 n.9.

Penn Power's repeated descriptions of the Perry I buyback as an "allocation" or "reallocation" of power (Petition at (i), 3, 14, 15, 17, 18 and 19) form the factual basis for the federal preemption issue it has presented to this Court. However, the record below is totally lacking in evidentiary support for the proposition that Penn Power's agreement to purchase 12 MW of Perry I power for 18 months was an "allocation" of power. *See* App. at 2b-4b. This explains why the factual basis underlying Penn Power's federal preemption argument to both the PUC and the Commonwealth Court was that the *rate* for the Perry I buyback was filed with FERC. *See* App. at 5b-6b.

Indeed, the documents on file with FERC clearly demonstrate that the Perry I buyback was not an "allocation" of power, but a mere sale by Cleveland Electric and a wholesale purchase by Penn Power. For example, because CAPCO is not an "integrated" power pool, Article 10 of the CAPCO Basic Operating Agreement ("BOA") on file with FERC does not provide a formula (as do the system agreements in *Nantahala* and *Mississippi Power)* for the allocation of capacity and/or energy between Penn Power and its parent company, Ohio

Edison Company ("Ohio Edison"), or among the other CAPCO members (such as Cleveland Electric).

Article 10 of the CAPCO BOA recognizes that, even within the operation of the Ohio Edison system, Penn Power and Ohio Edison each have the "sole responsibility" for allocating between themselves their collective obligations to the other CAPCO members. App. at 7b. In other words, the CAPCO BOA does not state specifically *how* Penn Power and Ohio Edison will meet their obligations to the other CAPCO members and does not constrain Penn Power or Ohio Edison in any manner. It most certainly does not constrain Penn Power and Cleveland Electric, the non-affiliated parties to the Perry I buyback. In addition, Appendix 7 to Schedule E of the CAPCO BOA, which sets forth a detailed formula for determining the *sales price* of power from Perry I, obviously does not "allocate" power between Penn Power and Cleveland Electric. *See* Petition, App. at 48a-49a.

Only after the Commonwealth Court properly noted that both *Nantahala* and *Mississippi Power* involved FERC-mandated allocations of power that clearly affected the wholesale rates of the affiliated utilities did Penn Power begin to describe the Perry I buyback as an "allocation" of power, first to the Pennsylvania Supreme Court and now to this Court. *Compare* App. at 6b and App. at 8b-9b. Penn Power's belated, inaccurate and repeated descriptions of the Perry I buyback as an "allocation" or "reallocation" of power as in *Nantahala* and *Mississippi Power* cannot make it so.

II. THE LOWER COURT'S RULING DOES NOT CONFLICT WITH THE FEDERAL POWER ACT OR DECISIONS OF THIS COURT

By enacting the Federal Power Act, "Congress meant to draw a bright line easily ascertained, between state and federal

jurisdiction." *FPC v. Southern California Edison Co.*, 376 U.S. 205, 215 (1964). This Court's decisions in *Nantahala* and *Mississippi Power* illuminated this bright line in the special situations where FERC is required to adjust voluntary allocations of power among affiliates in order to determine just and reasonable wholesale rates. The lower court's ruling in this case does not diminish the brilliance of this line because, as shown in Part I of this brief, the Perry I buyback had none of the special factors underlying FERC's jurisdiction in both *Nantahala* and *Mississippi Power*. Accordingly, the lower court's ruling properly distinguished this case from *Nantahala* and *Mississippi Power*, and cannot possibly conflict with those decisions or the Federal Power Act.

The allocation agreement between the affiliates in *Nantahala* directly affected NP&L's wholesale rate by determining the mix of low-cost entitlement power and high-cost purchased power that NP&L needed to provide electric service to its wholesale and retail customers. The Perry I buyback does not represent an allocation of Perry I power between Cleveland Electric and Penn Power; as FERC's order concerning the rate for the Perry I buyback makes clear, the amount of Perry I power utilized by each CAPCO member to meet its customer demand is based upon each member's ownership interest. *See* Petition, App. at 48a.

The Perry I buyback also in no way resembles the "System Agreements" among the affiliated utilities in *Mississippi Power*. System agreements allocating power among affiliated utilities operating within an integrated power pool system present a special challenge to the federal/state division of jurisdiction under the Federal Power Act. As the dissent in *Mississippi Power* explained:

> Interstate electricity pools, however, present special difficulties for the wholesale/retail division of jurisdiction because the "wholesale" transaction is from the pool to the utilities belonging to the pool, and thus the entities wholesaling the power are the same ones purchasing and retailing that power. As a result, a member utility's decision to participate in the pool's building or operation of a power plant is simultaneously a decision to purchase the power generated by that plant.

Mississippi Power at 386 (dissenting opinion).

FERC has also recognized the special situation presented by integrated, interstate power pool system agreements among affiliated utilities:

> [W]here, as here, the transaction involves affiliated, jurisdictional utilities, which are members of an integrated, interstate holding company arrangement, performing diverse functions on a coordinated basis, and particularly where differing interpretations are advocated concerning the parties' rights and obligations under the basic system agreements, the relevant issues may not be so readily segregated. Under these circumstances, more complex, interrelated questions arise and, whether one characterizes the questions as related to prudence, interpretation, or cost allocation, they are clearly matters most appropriately resolved by this Commission as part of its overriding authority to evaluate and implement all applicable wholesale rate schedules.

AEP Generating Co., 36 F.E.R.C. ¶ 61,226, p. 61,550 (1986).

The AEP system, unlike CAPCO, is an integrated, interstate power pool. *See* App. at 1a.

Both before[4] and after[5] this Court's decisions in *Nantahala* and *Mississippi Power,* FERC has recognized that pro-

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[4]*See Philadelphia Electric Co.*, 15 F.E.R.C. ¶ 61,264, p. 61,601 (1981) (FERC's acceptance of the contract and rate for the sale of nuclear-generated electric power from Salem-2 does not prejudge, for FERC's purposes or those of the state commissions, the prudence of the transactions.); *Southern Company Services, Inc.*, 20 F.E.R.C. ¶ 61,332, p. 61,694 (1982) (FERC's proceeding to determine whether unit power sale agreements between Southern Company Services and Florida Power and Light Company ("FP&L") are just and reasonable is not the proper forum for considering the complaint that FP&L's purchase is imprudent.); *Pennsylvania Power and Light Co.*, 23 F.E.R.C. ¶ 61,006, p. 61,018-19 (1983) (FERC does "not view its responsibilities under the Federal Power Act as including a determination that the purchaser has purchased wisely or has made the best deal available. However, these are legitimate concerns of the state commissions [when determining prudent cost support for sales to others]."); *Southern Company Services, Inc.*, 26 F.E.R.C. ¶ 61,360, p. 61,795 (1984) (FERC "is not empowered to disapprove or modify a power sales agreement on the grounds that the buyer may not be making the best possible deal."); *Pacific Power and Light Co.*, 27 F.E.R.C. ¶ 61,080, p. 61,148 (1984) (FERC's proceeding to determine whether the contract represents a reasonable cost basis for the sales rate is not the proper forum for determining the prudence of the purchaser's capacity purchase.); and *Southern Company Services, Inc.*, 28 F.E.R.C. ¶ 61,349, p. 61,636 (1984) ("All we have considered is whether the sale is just and reasonable. We have not determined whether it was a prudent purchase by GSU.") (footnote omitted).

[5]*See Monongahela Power Co.*, 39 F.E.R.C. ¶ 61,350, pp. 62,095-96 (1987) and *Public Service Co. of Indiana*, 49 F.E.R.C. ¶ 61,346, p. 62,244 n.24 (1989). ("Our action in accepting for filing and suspending PSI's Rate Schedule . . . should not be construed in any way as preempting or effecting whatever jurisdiction the [state commissions] may have over PSI under applicable state law. *Pike County Light & Power Co. v. Pennsylvania Public Utility Commission*, 465 A.2d 735 (1983).")

ceedings involving power allocations among affiliates represent the exception to the typical wholesale rate case involving wholesale power transactions between non-affiliates.

For example, in a case involving Penn Power and Ohio Edison, FERC declined the public service commission's request for a determination that the wholesale purchaser (PEPCO) acted reasonably or prudently in entering into the transaction:

> Given PEPCO's status as a *purchaser not affiliated with the OE [Ohio Edison] system or APS* [an intermediate system providing transmission of the power from OE to PEPCO], and not under any preexisting obligation under the terms of an *interconnection agreement, power pool,* or *other highly integrated contractual or corporate arrangement to make this purchase, we do not have jurisdiction in this proceeding over the question of whether PEPCO was prudent in entering into this transaction.* We may consider that question only in a rate proceeding in which PEPCO seeks to pass through the costs of the OE system purchase to wholesale ratepayers. Because PEPCO has not filed with the Commission any tariff seeking to pass the costs of its purchase from the OE system through to any of its wholesale customers, we have no basis in this proceeding for determining whether PEPCO acted prudently.

Monongahela Power Co., 39 F.E.R.C. ¶ 61,350, p. 62,095 (emphasis added; citations omitted).

In the *AEP Generating Co.* litigation cited above, FERC recognized the limitation on its jurisdiction in the typical wholesale rate case:

> The Commission stated [in a prior order] that it did not view its responsibilities under the Federal Power Act as including a determination that a purchaser had acted wisely, but that the question was a legitimate concern when the purchaser sought to pass through costs associated with the transaction in its rates for sales to others. 29 FERC at p. 61,501. *Under narrow, non-pool circumstances, that view would remain sufficient and dispositive.*

AEP Generating Co., 36 F.E.R.C. at p. 61,550 (emphasis added).

However, this case involved a typical wholesale rate case at FERC in which the reasonableness of Penn Power's wholesale purchase from Cleveland Electric was not and would not have been considered by FERC. *See* footnotes 4 and 5 *supra*. Indeed, FERC's order concerning the filing upon which Penn Power bases its federal preemption claim clearly demonstrates that FERC's concern in this case involved only the reasonableness of the cost support for Cleveland Electric's sale of Perry I power: "The Central Group companies are advised, however, that additional transactions under the proposed formula rate will require a timely filing, as a change in rates of company specific rate sheets detailing the proposed rate of return on equity and decommissioning costs, together with appropriate cost support." Petition, App. at 50a.

FERC's order also demonstrates that this case does not involve an agreement allocating wholesale power among affiliates in an integrated power pool that underlies the FERC jurisdiction exercised in *Mississippi Power* and *AEP Generating Co.*:

> All Central Group members are joint owners of the Perry unit. While any of the owners could con-

> ceivably sell from their owner ship [sic] entitlements, *Cleveland is expected to be the only seller*. At present, Cleveland is selling 80 MW of its 375 MW entitlement to Ohio Edison Company (Edison). *No other sales are currently anticipated.*
>
> . . . .
>
> The filing submitted here is specific to the 80 MW Cleveland/Edison transaction. *Cleveland reports that no other owners anticipate selling Perry unit power.*

Petition, App. at 48a, 50a.

Since this case involves a typical FERC wholesale rate case involving non-affiliates and is easily distinguished on its facts from *Nantahala* and *Mississippi Power*, the lower court's ruling obviously does not "trap" costs incurred by Penn Power pursuant to a FERC-mandated allocation of power.[6] Therefore, the lower court's ruling presents neither a threat to FERC's jurisdiction nor the case-by-case analysis of federal preemption rejected by this Court in *FPC v. Southern California Edison Co., Nantahala* and *Mississippi Power.*

The lower court's ruling simply affirmed the PUC's exercise of its portion of the wholesale/retail division of jurisdiction

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[6]An impermissible "trapping" of costs does not occur in every instance in which a state commission disallows the recovery of a retail electric utility's claimed cost of service. As the lower court noted, a utility bears the risk that expenses incurred may be found to be unreasonable in amount or imprudently incurred when the utility seeks to recover those expenses in rates. In this respect, the costs of the Perry I buyback are no different from those incurred pursuant to "a labor contract or a contract for the supplying of coal." Petition, App. at 14a. Only the "trapping" of costs that FERC determines to be just and reasonable and that FERC requires a utility to incur is impermissible under *Nantahala* and *Mississippi Power*.

created by the Federal Power Act. Thus, the lower court's ruling falls squarely within the circumstances this Court recognized as remaining within the authority of the states to decide:

> Without deciding this issue, we may assume that a particular *quantity* of power procured by a utility from a particular source could be deemed unreasonably excessive if lower-cost power is available elsewhere, even though the higher-cost power actually purchased is obtained at a FERC-approved, and therefore reasonable, *price*.

Nantahala at 972 (emphasis in original); *Mississippi Power* at 373. That is precisely what occurred in this case. The PUC determined that Penn Power did not need an additional 12 MW of capacity for 18 months to provide safe and reliable electric service to its retail customers. Petition, App. at 28a-29a.

A. The Lower Court's Ruling Affirmed The PUC's Legitimate Exercise Of Traditional State Ratemaking Authority Preserved To The States By The Federal Power Act.

Penn Power's federal preemption argument before the PUC was that, as in *Nantahala*, "the Federal Energy Regulatory Commission ("FERC") has preempted this Commission's authority to examine the *price paid* for Perry I capacity." Petition, App. at 28a (emphasis added). In *Nantahala*, the effect of the state commission's action was to set a new wholesale rate for NP&L in order to gain an economic advantage for NP&L's retail customers in North Carolina. The state commission accomplished this by substituting its own allocation of low-cost power for that previously determined by FERC. The record in this case establishes that the Pennsylvania commis-

sion made no attempt to redetermine the FERC-approved wholesale rate for Perry I power or to contradict any other FERC determination. The PUC simply did not examine the reasonableness of the price paid, i.e. the cost support, for the Perry I buyback. Indeed, the PUC's order stated that "We express no views on the reasonableness of the FERC-approved selling price of Perry I power." *Id.* at 29a.

In rejecting Penn Power's federal preemption claim, the PUC stated:

> We concur with the ALJ that *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 74 PUR4th 464, 90 L.Ed.2d 943, 106 S.Ct. 2349 (1983) [sic] is irrelevant to our decision herein because we are merely reviewing the purchase of a particular quantity of power which we have found to be unreasonably excessive and unnecessary for Penn Power to provide safe and reliable service to its Pennsylvania customers, and since lower cost power is readily available to the Company *if* it were needed.

Id. (emphasis in original).

The lower court agreed with the PUC that this case did not involve a FERC-mandated allocation of power as in *Nantahala,* but instead represented the legitimate exercise of state jurisdiction over a utility's retail rates as in *Pike County Light and Power Co. v. Pa. P.U.C.*, 77 Pa. Commw. 268, 465 A.2d 735 (1983). The Commonwealth Court below stated:

> Because FERC did not mandate the particular purchase involved in this case, or otherwise limit Penn Power's options for purchasing power, the PUC's decision here is simply a *state determination* that Penn Power's agreement to purchase the *quantity* of power specified in the 1980 agreement at the

> FERC-approved rate was *unreasonably excessive* when lower cost power was readily available elsewhere.

Id. at 20a (emphasis added).

Since this Court's decision in *Mississippi Power* rested on the same foundation as *Nantahala,* the lower court properly held that *Mississippi Power* also did not preempt the PUC's exercise of traditional state ratemaking authority in this case. *Id.* at 21a-22a. Thus, the Commonwealth Court's ruling affirming the PUC's action in this case is in perfect harmony with this Court's decisions in *Nantahala* and *Mississippi Power*:

> The PUC's decision does not constitute an impermissible state determination that FERC-approved rates are not reasonable nor does it result in the trapping of costs that FERC has ordered a utility to incur.

Id. at 20a. *See also Kentucky West Virginia Gas Co. v. Pa. P.U.C.* 837 F.2d 600 (3d Cir. 1988), *cert. denied,* 488 U.S. 941 (1988). Penn Power's position would completely insulate a retail utility's wholesale power purchase decisions from state review in situations wholly outside the reach of FERC's jurisdiction under the Federal Power Act.

III. NEW ORLEANS PUBLIC SERVICE INC. V. COUNCIL OF THE CITY OF NEW ORLEANS CAN HAVE NO EFFECT ON THE VALIDITY OF THE LOWER COURT'S RULING IN THIS CASE.

Penn Power invites this Court to defer a ruling on its petition pending a decision in *New Orleans Public Service Inc. v. Council of the City of New Orleans*, No. 90-1156 ("*NOPSI*"). Petition at 20-23. *NOPSI* is yet another case arising from the extensive litigation concerning the construction of the Grand Gulf 1 nuclear power plant and FERC's allocation of its costs

among the four operating companies comprising the Middle South Utilities ("MSU") integrated, interstate power pool.

NOPSI involves the same FERC-mandated allocation addressed by this Court in *Mississippi Power*; thus, this Court's decision in *NOPSI* cannot affect the validity of the lower court's ruling in this case, which involves a wholesale transaction between non-affiliated utilities not operating an integrated, interstate power pool. Since this case involves a wholesale purchase of power by a utility that was not constrained or compelled by FERC in any manner to make the purchase, *Nantahala* and *Mississippi Power* are simply inapplicable. Consequently, this Court's decision in *NOPSI* will also be inapplicable to this case.

Both New Orleans Public Service, Inc. and FERC recognize that *NOPSI* is not applicable to this case, which involves the typical situation where FERC does not review the reasonableness or prudence of the retailing utility's purchase decision. *See* App. at 10b-11b. Therefore, there is no need for this Court to defer a ruling on Penn Power's petition pending a decision in *NOPSI*.

CONCLUSION

Because this case presents no viable federal question concerning this Court's precedents in *Nantahala* and *Mississippi Power* or FERC's jurisdiction under the Federal Power Act, Penn Power's petition for a writ of certiorari should be denied.

Respectfully submitted,
JOHN F. POVILAITIS
Chief Counsel
BOHDAN R. PANKIW
First Deputy Chief Counsel

KEVIN J. MOODY*
Assistant Counsel
Attorneys for Respondent
Pennsylvania Public Utility Commission

*Counsel of Record

Commonwealth of Pennsylvania
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265
(717) 787-5000

July 22, 1991

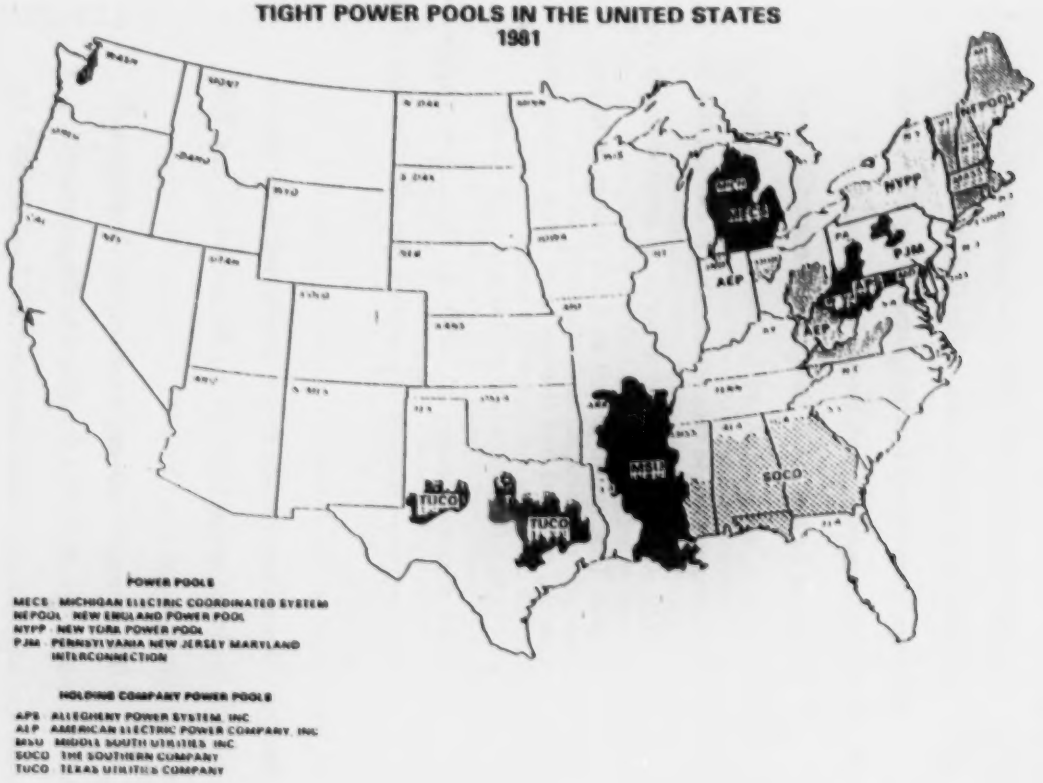


Figure 2.1 Tight Power Pools in the United States, 1981

27. Q. Did the Company recently file a revision to its annual ECR?

A. Yes. On November 16, 1987, the Company filed a revised ECR to become effective on the first day of commercial operation of Perry 1, which occurred on November 18, 1987. In its filing the Company proposed that it postpone its next ECR filing, which normally would become effective on April 1, 1988, until completion of the Company's base rate proceeding at Docket No. R-870732, which is expected to occur on approximately May 4, 1988. That would permit an ECR change to reflect potential reduced fuel charges from Perry 1 concurrent with base rate recognition of this new unit. In an Order entered January 22, 1988, the Commission approved the Company's request to postpone the effective date of the ECR.

28. Q. Please describe the major reasons for the proposed increase in the ECR from 1.741 mills/kwh to 6.768 mills/kwh.

A. There are several major reasons for the proposed increase. First, the Company has experienced significant undercollections since April 1, 1987. In its Order entered January 22, 1988, the Commission approved the portion of the ECR increase attributable to the increased energy costs. Second, a portion of the

proposed ECR increase reflects the impact of the buy/sell agreements between Penn Power and Ohio Edison discussed above, which were filed concurrently with the revised ECR filing. Third, the Company's ECR filing reflects the Company's costs associated with the purchase of 12 Mw of Perry 1 generating capacity from Cleveland Electric.

29. Q. Please explain the basis for the Company's purchase of 12 Mw of Perry 1 capacity from Cleveland Electric.

A. In January 1980, CAPCO decided to terminate construction of four planned units: Davis-Besse Nuclear Units Nos. 2 and 3 at Port Clinton, Ohio and Erie Nuclear Units Nos. 1 and 2 at Berlin Heights, Ohio. That decision was based on growing political and regulatory uncertainties arising from the Three Mile Island incident, serious financial constraints of various CAPCO companies, and reduced need for future capacity. At the same time, and as part of the cancellation package, Cleveland Electric agreed to acquire 12 Mw of Penn Power's original 75 Mw share of Perry 1. In return for its agreement to purchase 12 Mw of Perry 1 from the Company, however, Cleveland Electric required the Company to buy back from Cleveland Electric that 12 Mw for an 18-month period, beginning on the date that Perry 1 achieved commercial operation. It was further agreed that the short-term 12

Mw buyback would be made in accordance with the terms and conditions set forth in the CAPCO Basic Operating Agreement.

30. Q. What ratemaking treatment has the Company proposed with respect to the 12 Mw Perry 1 buyback?

A. Simply that all of the costs associated with the buyback be recovered from ratepayers through the Company's ECR. Such ECR treatment would include reconciliation for over/under collections. ECR recovery represents the most convenient and appropriate method to reflect the costs associated with this short-term purchase of power and will hopefully avoid the need for interim base rate filings.

31. Q. Have any of the documents associated with the Affiliated Interest Agreements or the 12 Mw Perry 1 buyback been filed with FERC?

A. Yes. The CAPCO Basic Operating Agreement and all appendices thereto have been filed with FERC. In particular, the specific formula for determining the price to be paid for the buy/sell agreements at issue here as well as the 12 Mw Perry buyback, contained in the CAPCO Basic Operating Agreement, have been filed with FERC.

of alternative energy purchases. Finally, and most importantly, the ALJ did not take issue with the volume or quantity of capacity purchased.

The Recommended Decision concludes: "Purely and simply, the incurrence of costs by Penn Power does not result in Penn Power being guaranteed recovery of those costs through its rates." (R.D., p. 26). The Company respectfully submits that the ALJ has it backwards. In fact, the doctrine of preemption, as outlined by the Supreme Court, protects utilities from a rate disallowance based upon an examination of the price of power purchased pursuant to a rate filed at FERC, the very disallowance that the ALJ recommends in this proceeding. *Nantahala,* 90 L. Ed. 2d at 956 ("The filed-rate doctrine *ensures* that sellers of wholesale power governed by FERC can recover the costs incurred by their payment of just and reasonable FERC-set rates.") (emphasis added). Along these same lines, the ALJ suggests that "an adjustment to the Company's ECR has no effect on any FERC filed rate." (R.D., p. 24). Yet, an adjustment to the Company's ECR would be tantamount to an adjustment to the rate filed at FERC in that the resulting ECR would only provide for partial recovery of the FERC rate. Significantly, *Nantahala* specifically prohibits such "trapping" of costs because it would result in indirect interference with the rates filed at FERC. 90 L. Ed. 2d at 956.

fixed allocation compelled the state to permit the full recovery of the cost of the power.[13]

Application of the *Mississippi Power/Nantahala* principle in the present case is straightforward. As explained above, the rate paid by Penn Power for the interstate, wholesale power purchase at issue here is on file with FERC. Since the Commission "may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable" and since the "state utility commission setting retail rates must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined

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[13] The Court in *Mississippi Power* quoted with approval certain of the key passages from *Nantahala* cited above and expanded upon the principles articulated therein. For example, the Court stated:

> "States may not bar regulated utilities from passing through to retail consumers FERC-mandated wholesale rates. 'The filed rate doctrine ensures that sellers of wholesale power governed by FERC can recover the costs incurred by their payment of just and reasonable FERC-set rates.' " 108 S. Ct. at 2439.

The Court also stressed:

> "In this case as in *Nantahala* we hold 'that. . . . [o]nce FERC sets [a wholesale] rate, a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable. A state must rather give effect to Congress' desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the States do not interfere with this authority.' " *Id.* at 2440.

ARTICLE 10
Ohio Edison System

10.01 Ohio Edison Company and Pennsylvania Power Company shall be considered to be separate Parties under this Agreement whenever and to the extent that separate corporate action is required of such Companies in order to accomplish the purpose of this Agreement, but their liability and responsibility for the performance of any obligation of OE hereunder to the other Parties shall be joint and several. All billings, payments, notices or requests shall be made by or to Ohio Edison Company on behalf of both. The allocation between Ohio Edison Company and Pennsylvania Power Company of their collective obligations hereunder as OE shall be the sole responsibility of said Companies, but they undertake that they will, during the period that they shall be obligated under this Agreement, have in force one or more arrangements for the allocation of the whole of such collective obligations and will, upon the request of any of the other parties hereto, furnish the requesting Party or Parties satisfactory evidence of the existence of their then effective arrangements relating to such allocation.

incurred as a result of paying a FERC-determined wholesale price." 476 U.S. at 965. The Court further emphasized that "interstate power rates filed with FERC or fixed by FERC must be given binding effect by state utility commissions determining intrastate rates." *Id.* at 962. The Court stated that any other result would lead to the impermissible "trapping" of costs at the wholesale level, meaning that the wholesaler was obligated to pay the FERC-approved rate on the one hand, but unable to recover those costs in its retail rates on the other. *Id.* at 969-70.

Application of this holding in the present case is straightforward. The Perry 1 buyback was a reallocation of the Perry 1 capacity as between CEI, Penn Power and Ohio Edison. This reallocation is reflected in the rate that Penn Power had to pay for energy and capacity under the Perry 1 buyback,[14] and that rate has been filed with and approved by

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[14]The rate schedule at issue is the filed rate as of November 18, 1987, in light of the FERC Order of July 29, 1988 accepting the rates for filing, subject to FERC investigation. *See* 44 F.E.R.C. ¶ 61,179 (1988). This acceptance by FERC makes the rate schedule the official "filed rate," even though the potential existed at that time for subsequent modification and refund. A state court or commission must accept the rate on file with FERC as the "filed rate," and are not permitted to speculate about what adjustments FERC might conceivably make at some future date. *See Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 580-82 (1981); *Narragansett Electric Co. v. Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978).

FERC.[15] The PUC disallowed recovery of the Perry 1 buyback costs on the ground that they were unreasonable. Because the PUC "may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable," *id.* at 966, the PUC was preempted from making the disallowance at issue in this case.

The PUC's decision results in the very "trapping" of costs at the wholesale level that *Nantahala* expressly condemned: Penn Power is obligated to purchase 12 Mw of capacity and energy from CEI and to pay the rate on file with FERC for that power, but Penn Power cannot recover most (approximately 90%) of those costs in its retail rates. The FERC-filed rate in this case had two elements: (a) a charge for the amount of energy actually purchased, and (b) a charge for capacity, i.e., part of the fixed cost of producing the energy. The PUC and Commonwealth Court below essentially allowed Penn Power to pass on to its customers only the

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[15] As contemplated by longstanding United States Supreme Court practice in the FERC preemption area, Penn Power uses the term "approved" rate, rate schedule or agreement in this brief as generic to any rate, rate schedule or agreement that has been accepted for filing by FERC, whether or not challenged before FERC by the PUC, the OCA or others, and whether or not modified by FERC. *Montana Dakota Utilities*, 341 U.S. at 251. *See* text at pages 33-36, *infra*.

[21]These decisions all recognize that when FERC exercises its jurisdiction to allocate wholesale costs among affiliated utilities in integrated systems—or otherwise to mandate costs-these determinations bind states in setting retail rates. *Kentucky Power Co. v. Kentucky Public Service Comm'n*, No. 86-CA-1031-MR (Kentucky Court of Appeals, June 2, 1988); *Kentucky West Virginia Gas Co. v. Pennsylvania Public Utility Comm'n* 862 F.2d 69, 74 (3d Cir. 1988) (state commission must allow utility to pass through FERC-mandated minimum bill liability to retail customers). Thus, the only circumstances in which lower courts have permitted states to bar recovery of expenses incurred under FERC rate schedules is where FERC regulation has *not* allocated the costs to a particular utility, but has given the utility a choice to obtain the power from one of many sources. *See, e.g., Kentucky West Virginia Gas Co. v. Pennsylvania Public Utility Comm'n*, 837 F.2d 600 (3d Cir. 1988); *Pike County Light & Power Co. v. Pennsylvania Public Utility Comm'n*, 465 A.2d 735 (Penn. Commwlth Ct. 1983). As the Fifth Circuit held, that was not the case here, and the "*Pike County* line of cases" is inapposite here. App. 15A.

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[12] The court correctly acknowledged, however, that the so-called *"Pike Co."* exception to FERC's exclusive wholesale jurisdiction—when a utility imprudently purchases unnecessary quantities of high-cost power at FERC-approved rates—was inapplicable. Pet. App. 15A; see, *e. g.*, *Kentucky-West Virginia Gas Co. v. Pennsylvania Pub. Utilities Comm'n*, 837 F.2d 600 (3d Cir. 1988); *Pike County Light & Power Co. v. Pennsylvania Pub. Utility Comm'n*, 77 Pa. Commw. 268, 465 A.2d 735 (1983). That exception does not apply where, as here, FERC has determined the amount of power that each operating utility in the interstate pool, was obligated to purchase. See *Mississippi Power & Light Co.*, 487 U.S. at 373-374.